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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Soviet Hard Currency Payments Position Improves in 1971

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
August 1972

INTELLIGENCE MEMORANDUM

SOVIET HARD CURRENCY PAYMENTS POSITION
IMPROVES IN 1971

Introduction

1. The Soviet hard currency payments position showed increasing deficits during 1968-70, primarily because the USSR imported larger quantities of both Western equipment and technology to modernize Soviet industry and selected commodities to compensate for short supplies in the USSR and Eastern Europe. As a result of extensive use of credits in this period, the USSR now has a large external debt with the West. This memorandum describes developments in the Soviet trade and payments position with convertible currency countries during 1971 and probable trends for 1972.

Summary and Conclusions

2. The Soviet hard currency balance improved in 1971, but will worsen greatly in 1972. The USSR, however, has ample gold reserves and available credit to handle this problem. The Soviet hard currency trade deficit was US \$309 million in 1971, compared with \$500 million in 1970. A rapid growth in exports was largely responsible for the decrease, with hard currency earnings boosted by large price increases on Soviet crude oil and petroleum products exported to the West. Soviet imports continued to rise, but at a slower rate as the level of machinery and equipment imports reflected the slowdown in orders from the West in 1970.

3. The USSR continued to utilize medium-term and long-term credits to cover its hard currency deficit in 1971. The Soviets netted an estimated \$439 million in credits in 1971, bringing the USSR's total indebtedness to approximately \$2.2 billion. Gold sales during 1971 remained minor,

Note: This memorandum was prepared by the Office of Economic Research.

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allowing the USSR to continue to add to its gold reserves, estimated at \$2.1 billion by the end of 1971.

4. The Soviet trade deficit should more than double in 1972, spurred by large-scale imports of grains and sugar. Expected increases in Western deliveries of machinery and equipment should further boost the level of Soviet imports in 1972. Drawings against medium-term and long-term credits again will cover the major portion of the anticipated deficit. The size of Soviet gold reserves and increasing world prices make substantial gold sales a strong probability, and a consortium loan is not out of the question.

Discussion

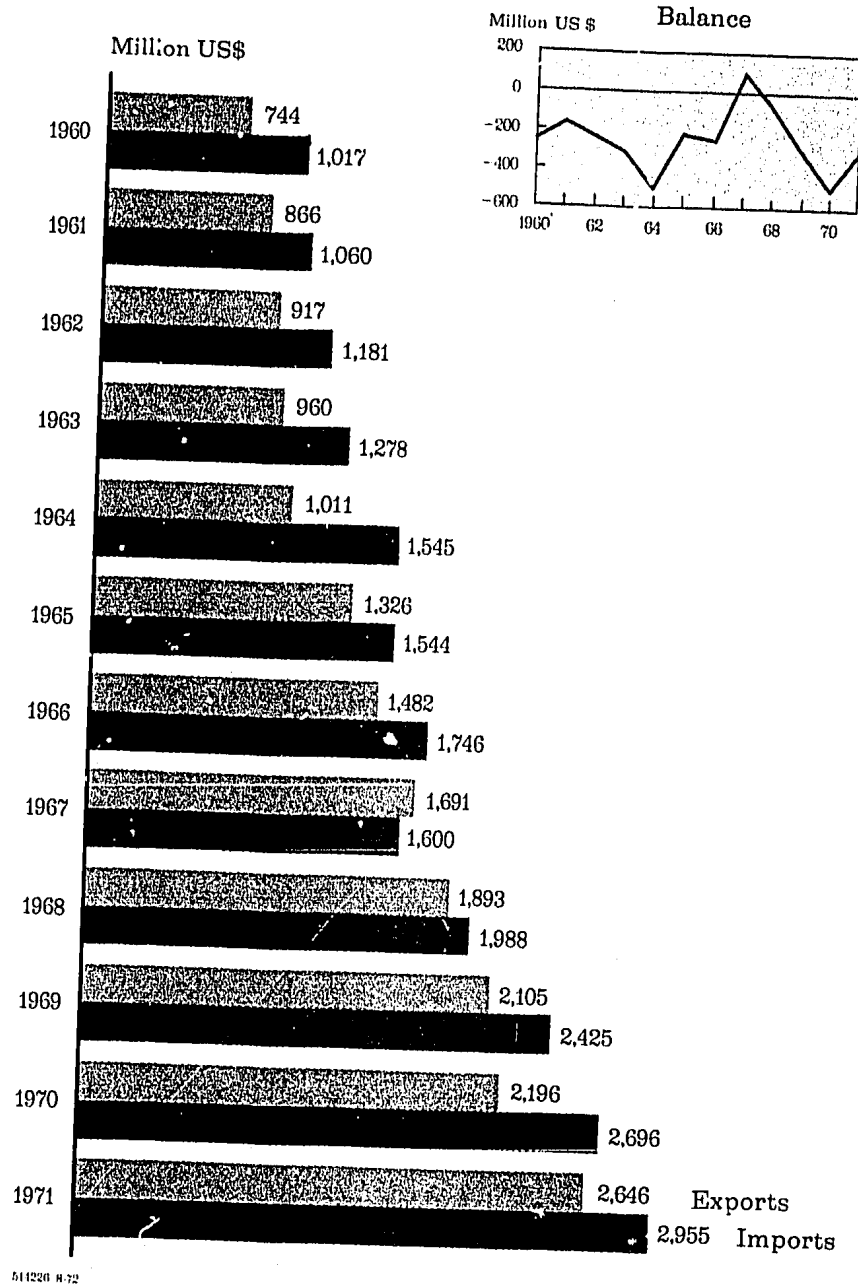
5. The Soviet hard currency trade deficit of \$309 million in 1971 (see the chart) was a sharp improvement over the \$500 million deficit in 1970. Exports to hard currency nations in 1971 rose by a record \$450 million, reaching \$2.65 billion, while hard currency imports were up \$259 million, reaching \$2.96 billion -- well below the 1968-70 average growth in imports of \$365 million.

6. The major share of Soviet hard currency trade is conducted with Western Europe and is characterized by Soviet exports of raw materials and imports of machinery and equipment and other finished products. In 1971, Soviet exports to Western Europe grew by \$310 million while imports rose by less than \$100 million, enabling the USSR to achieve a hard currency trade surplus with Western Europe of \$68 million -- the first surplus with this area since 1967 (see Table 1). The Soviet trade balance with several of its major trading partners in Western Europe markedly improved in 1971; the Soviet surplus with the United Kingdom increased by \$13 million and its deficits with Italy and France decreased by a combined total of \$151 million (see Table 2). These gains were offset in part by a \$74 million increase in the Soviet trade deficit with West Germany.

7. The level of imports from almost all West European nations declined.⁽¹⁾ Soviet imports from the United Kingdom dropped by \$26 million, probably as a result of the relatively high interest rates for new credits in the United Kingdom during most of 1970-71. Imports from Italy also declined in 1971, led by a \$63 million drop in Italian deliveries of

1. Soviet imports from Western Europe would have remained unchanged from 1970, except for the Soviet-Austrian switch from a bilateral clearing to hard currency settlements beginning in 1971. Although Soviet imports from Austria also fell in 1971 to \$90 million -- down \$8 million -- the entire \$90 million import figure is counted as a net rise in the USSR's hard currency trade with Western Europe.

Soviet Hard Currency Trade



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Table 1

Distribution of Soviet Hard Currency Trade
with Western Europe and Overseas Countries a/

| Million US \$ | | | |
|------------------------|----------------|----------------|----------------|
| <u>Geographic Area</u> | <u>Exports</u> | <u>Imports</u> | <u>Balance</u> |
| 1967 | <u>1,691</u> | <u>1,600</u> | <u>+91</u> |
| Western Europe | 1,163 | 1,015 | +148 |
| Overseas areas | 528 | 585 | -57 |
| 1968 | <u>1,893</u> | <u>1,988</u> | <u>-95</u> |
| Western Europe | 1,282 | 1,363 | -81 |
| Overseas areas | 611 | 625 | -14 |
| 1969 | <u>2,105</u> | <u>2,425</u> | <u>-320</u> |
| Western Europe | 1,462 | 1,622 | -160 |
| Overseas areas | 643 | 803 | -160 |
| 1970 | <u>2,196</u> | <u>2,696</u> | <u>-500</u> |
| Western Europe | 1,547 | 1,696 | -149 |
| Overseas areas | 649 | 1,000 | -351 |
| 1971 | <u>2,646</u> | <u>2,955</u> | <u>-309</u> |
| Western Europe | 1,857 | 1,789 | +68 |
| Overseas areas | 789 | 1,167 | -378 |

a. Because of rounding, components may not add to the totals shown.

machinery and equipment following completion of the major portion of Italian deliveries for the Fiat plant at Tol'yatti. Imports from West Germany ran counter to this trend, rising \$109 million, including a \$47 million increase in deliveries of large-diameter pipe.

8. Soviet exports to Western Europe of \$1.9 billion in 1971 showed a record increase of \$310 million, far above the 1968-70 average export gain of \$128 million. Inclusion of Austria accounted for one-third of the gain (\$109 million), but the USSR also increased the level of its exports to all of its hard currency trading partners in Western Europe, except the

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Table 2
Soviet Hard Currency Trade
with Selected West European Countries

| <u>Country</u> | <u>Million US \$</u> | | | | | |
|----------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| | <u>1970</u> | | | <u>1971</u> | | |
| | <u>Ex- ports</u> | <u>Im- ports</u> | <u>Bal- ance</u> | <u>Ex- ports</u> | <u>Im- ports</u> | <u>Bal- ance</u> |
| West Germany | 257 | 375 | -118 | 292 | 484 | -192 |
| United Kingdom | 465 | 248 | 217 | 452 | 222 | 230 |
| France | 140 | 319 | -179 | 216 | 313 | -97 |
| Italy | 212 | 313 | -101 | 259 | 291 | -32 |
| Sweden | 117 | 143 | -26 | 123 | 95 | 28 |

United Kingdom. Much of this gain in Soviet exports came from crude oil and petroleum. The USSR, following the example of the major oil exporting countries in 1971, increased its prices on crude oil and petroleum products by as much as 33%, bringing an increase in earnings of \$165 million. France, Italy, and West Germany are all major importers of Soviet crude oil and petroleum products, and higher prices for these products were major factors in the increased value of the USSR's exports to these nations.

9. Approximately one-third of the USSR's hard currency trade is conducted outside of Western Europe, primarily with Japan, the United States, Canada, and Iraq (see Table 3). Except for Japan and the United States, trade with non-European areas consists primarily of Soviet imports of raw materials and semimanufactured goods and exports of finished products and semimanufactured goods. Despite a substantial growth in exports to non-European nations to \$789 million - up \$140 million - Soviet imports from non-European areas rose by a greater amount - up \$167 million, reaching \$1.2 billion - increasing the Soviet trade deficit with these nations by \$27 million to a total of \$378 million.

10. The growth in Soviet hard currency imports from non-European areas in 1971 resulted largely from increased imports of consumer staples such as grain, sugar, cocoa, and livestock. In addition, imports of plant and equipment from Japan continued their substantial growth in 1971,

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Table 3

Soviet Hard Currency Trade
with Selected Non-European Countries

| Country | Million US \$ | | | | | |
|---------------|---------------|----------|----------|----------|----------|----------|
| | 1970 | | | 1971 | | |
| | Ex-ports | Im-ports | Bal-ance | Ex-ports | Im-ports | Bal-ance |
| Japan | 379 | 345 | 34 | 419 | 396 | 23 |
| United States | 64 | 115 | -51 | 60 | 144 | -84 |
| Canada | 8 | 131 | -123 | 14 | 151 | -137 |
| Iraq | 66 | 5 | 61 | 110 | 6 | 104 |
| Malaysia | 2 | 123 | -121 | 2 | 86 | -84 |

accounting for most of the \$51 million rise in total Soviet imports from Japan. The increase in hard currency imports from non-European areas would have been even greater in 1971 had the Soviets not benefited from a substantial decline in price in natural rubber which, taken together with a decrease in natural rubber imports from Malaysia and Indonesia, reduced Soviet imports of rubber from these nations by \$54 million.

11. Soviet exports to non-European areas in 1971 were up \$140 million, compared with a \$6 million gain in 1970. Most of the increase resulted from a \$44 million increase in exports to Iraq, reflecting increased Soviet deliveries of equipment for the development of the Rumaylah oilfields and a \$40 million gain in Soviet exports to Japan, primarily from increased deliveries of cotton and higher prices charged for crude oil and timber. Minor gains were registered in exports to many of the remaining non-European nations, although Soviet exports to the United States fell slightly to \$60 million.

Balance of Payments

12. Various nonmerchandise elements also affect the USSR's hard currency position. Receipts from tourism continued their rise in 1971, netting the USSR about \$75 million (see Table 4). Transportation charges also continued to give the USSR net hard currency revenues, with 1971

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Table 4

Estimated Soviet Hard Currency
Balance of Payments

| | Million US \$ | | | |
|---|---------------|------------|------------|------------|
| | 1970 | | 1971 | |
| | Credit | Debit | Credit | Debit |
| Goods and services | -- | <u>482</u> | -- | <u>283</u> |
| Merchandise, f.o.b. <u>a/</u> | 2,196 | 2,696 | 2,646 | 2,955 |
| Transportation, net | 35 | -- | 50 | -- |
| Travel | 81 | 19 | 96 | 21 |
| Interest repayments on credits <u>b/</u> | -- | 79 | -- | 99 |
| Transfer payments <u>c/</u> | -- | <u>48</u> | -- | <u>54</u> |
| Capital and monetary gold | <u>509</u> | -- | <u>526</u> | -- |
| Medium-term and long-term credits | 750 | 326 | 850 | 411 |
| Repayments on credits advanced by USSR <u>d/</u> | 90 | -- | 74 | -- |
| Monetary gold | 5 | -- | 25 | -- |
| Compensation payments <u>e/</u> | -- | 10 | -- | 10 |
| Net errors and omissions <u>f/</u> | <u>21</u> | -- | -- | <u>191</u> |

a. Official Soviet statistics adjusted to exclude estimated Soviet deliveries of goods and services to hard currency countries under economic aid agreements as well as goods received by the USSR as repayment and interest.

b. Interest payments are those made on medium-term and long-term credits obtained from Western countries mainly to finance imports of machinery and equipment. Interest payments and receipts for short-term loans are not included.

c. Payments made in hard currency to the United Nations and UN-affiliated organizations.

d. Military credit agreements between the USSR and some less developed countries such as Iraq, Syria, Indonesia, and Uganda provide for repayment in hard currency. This provision is not always honored, and estimates of what is actually paid are highly tentative. Hard currency repayments on economic aid have been added to these estimates.

e. Compensation payments are Soviet payments of principal and interest in accordance with the US lend-lease "pipeline" agreement.

f. Including changes in hard currency holdings and short-term capital movements.

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net receipts rising \$15 million to roughly \$50 million. These earnings were offset by interest payments of \$99 million and other debits. On balance, nonmerchandise elements in the Soviet current account were still in deficit.

13. The USSR continued to use Western credits to finance the major portion of its hard currency deficit. Estimated drawings on medium-term and long-term credits rose by \$100 million to \$850 million in 1971. Scheduled credit repayments also rose in 1971 to \$411 million, giving the USSR an estimated \$439 million in net credits for the year, compared with \$424 million in 1970. By the end of 1971, total Soviet indebtedness to the West was estimated at \$2.2 billion. The USSR also employs short-term credit facilities to help finance deficits. The USSR has traditionally been a net debtor on short term and apparently was a major net borrower on the Eurodollar market in 1971, when estimated net Soviet Eurodollar liabilities increased by \$450 million to \$600 million.

14. The USSR continued to add to its gold reserves in 1971. Sales were small - 20 metric tons valued at \$25 million. Gold production was estimated at \$275 million in 1971⁽²⁾ and domestic consumption at about \$50 million; as a result, the USSR added approximately \$225 million in gold to its reserves. Such reserves are believed to have reached \$2.1 billion at the close of 1971.

Prospects for 1972

15. The USSR's hard currency trade deficit in 1972 may more than double the 1971 figure of \$309 million, perhaps reaching \$800 million or more, far above the record deficit of more than \$530 million in 1964. The USSR has contracted for approximately \$925 million in deliveries of wheat, corn, and soybeans from the West during 1972, including more than \$500 million from the United States. Soviet contracts for these products for delivery in fiscal year 1973 total almost \$1.4 billion, roughly one-half of which will be delivered in 1972. Hard currency imports of sugar also are expected to exceed \$100 million. West German deliveries of large-diameter pipe in 1972 should approximate the 1971 level of \$148 million, and Italian pipe deliveries should increase substantially during 1972. Moreover, Soviet orders for plant and equipment have picked up substantially since mid-1970, presaging a rise in machinery and equipment imports during 1972. The USSR may be forced to cover a portion of such increases through cutbacks in imports of other goods. While imports of meat and meat products, which were at an all-time high in 1971, should

2. Computed at a price of \$38 per troy ounce.

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decline somewhat in 1972, a massive reduction in the level of Soviet imports of consumer goods may also be required to keep the hard currency trade deficit at a manageable level.

16. Increased Soviet hard currency exports would also serve to alleviate the trade deficit, but prospects for these increases are limited. Continued price rises should boost earnings from oil exports, but the quantity available for export is not expected to change significantly. No major changes are anticipated among the nonmerchandise elements of the USSR's current account, with expected increases in net earnings from transportation and tourism balanced by increased obligations for interest and other payments.

17. The USSR will draw heavily on medium-term and long-term credits to cover a major portion of the 1972 deficit. The large purchases of grain and sugar for 1972, however, were mainly on a cash basis and will require payment in 1972.⁽³⁾ The Soviets sold only small quantities of gold in 1971, but if they choose they could cover a substantial portion of their 1972 cash purchases through increased gold sales. By selling out of current production and allowing for domestic needs (thus leaving reserves untouched) the USSR would be able to sell up to 225 tons of gold on the free market in 1972. With South African sales far below normal levels and basic private demand steadily rising, the USSR could probably market up to 200 tons of gold during the second half of 1972 without causing the free market price to fall substantially. Ignoring speculative factors, Soviet sales would probably not reduce the price below \$65 per troy ounce, the price prevailing at mid-1972. Sales of 200 tons at \$65 per ounce would earn the USSR \$418 million.

18. The Soviets could also help cover their hard currency needs either by forming a consortium loan or by using a portion of the medium-term credits recently raised by the International Bank for Economic Cooperation (IBEC). In 1964, for example, Moscow Narodny Bank organized a \$112 million medium term consortium loan from British banks to cover the cost of grain purchases from Australia. A combination of gold sales, medium-term and long-term credits, import restrictions, and/or a consortium or IBEC loan would see the Soviets through this period of exceptional demand for foreign exchange.

3. Of the \$500 million in US grain exports for 1972, the USSR has requested only \$141 million in three-year Commodity Credit Corporation credits to date. Soviet grain purchases from all other nations are on a cash basis.

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